

BILL # HB 2183

TITLE: education savings trusts

SPONSOR: Biggs

STATUS: As Introduced

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FISCAL ANALYSIS

Description

HB 2183 requires the Arizona Department of Education (ADE) to establish and maintain education savings trusts into which deposits can be made by parents or legal guardians of students attending a private school in grades K-12 or an institution of higher education. Monies deposited into a trust would be invested by the State Treasurer and could be used to pay tuition and fees of any qualifying pupil. HB 2183 also establishes the Statewide Educational Choice Administration Fund, which would be managed by ADE to pay the costs associated with administering education savings trusts. The bill exempts from state income taxation any interest earned and distributed from education savings trusts.

Estimated Impact

The bill would reduce General Fund collections as taxpayers shift their holdings from taxable accounts to non-taxable savings trusts. The amount of the reduction cannot be determined in advance, though it will likely be no more than \$(2.1) million. Arizonans are estimated to pay that dollar amount in state taxes for Coverdell Education Savings Accounts (ESA) which exempt similar investments from federal taxes. A reduction in General Fund revenues of this magnitude is unlikely to occur, as it would require investors to move Coverdell ESA investments into an account managed by the State Treasurer or invest monies with the State Treasurer in excess of the Coverdell ESA \$2,000 contribution limit. For every \$1 million in investment earnings diverted from taxable interest-bearing and equity accounts to the new non-taxable education savings trusts, state General Fund revenues would decrease by approximately \$(35,000).

The bill also potentially could increase operating costs of the Arizona Department of Education and the State Treasurer. HB 2183 does not provide initial funding for ADE to address the additional workload associated with this program. The program would eventually fund itself with monies transferred into the new Statewide Educational Choice Administration Fund.

The Arizona Department of Revenue does not have a revenue impact estimate for the bill.

Analysis

HB 2183 requires any interest earned from investing in education savings trusts to be exempt from state income taxation, which will reduce General Fund collections when funds are diverted from taxable interest-bearing and equity accounts to the new non-taxable education savings trusts.

At the federal level, taxpayers may establish a Coverdell ESA to finance qualified education expenses associated with K-12 and higher education for a designated beneficiary. While this type of account is similar to the education savings trust established in HB 2183 in that it allows investments to finance K-12 education expenses, they differ in that annual contributions to Coverdell ESAs are limited to \$2,000 and are not state tax exempt, though they are federal tax exempt. Like education savings trusts, interest earnings and withdrawals from the account are exempt from federal taxation.

The Joint Committee on Taxation estimates that in 2001 federal revenue lost from these accounts is equivalent to \$(671) million. This amount represents the portion of interest earned on these accounts that would have otherwise been collected for federal income taxation. On average, the marginal federal income tax rate is 18.8%. This analysis assumes a 25% marginal federal income tax rate to reflect the tendency of higher income individuals to use this tax benefit. Therefore, the total amount of interest in these accounts is equal to \$2.7 billion ($\$671 \text{ million} / 25\% = \2.7 billion). Because Arizona residents represent 2% of the national population, this analysis assumes that 2% of the \$2.7 billion in interest is attributable to

investments by Arizona residents, which is equivalent to \$54 million ($\$2.7 \text{ billion} \times 2\% = \54 million). In tax year 2004, the average individual income tax rate for Arizona residents was approximately 3.5%. This analysis assumes a 4% marginal rate to reflect the tendency of higher income individuals to use this tax benefit. Assuming that parents and legal residents collectively earn the same amount of interest as they are estimated to earn from investing in Coverdell ESAs in 2006, state General Fund revenues would decrease by approximately \$(2.1) million ($\$54 \text{ million} \times 4\% = \2.1 million).

A reduction of \$(2.1) million in General Fund revenues is unlikely to occur, as it would require investors to move Coverdell ESA investments into an account managed by the State Treasurer or invest monies with the State Treasurer in excess of the Coverdell ESA \$2,000 contribution limit. Coverdell account holders can choose to invest their funds in a wide variety of interest-bearing investments and equities. For every \$1 million in investment earnings diverted from taxable interest-bearing and equity accounts to the new non-taxable education savings trusts, Arizona individual income tax revenues would decrease by about \$(35,000) ($\$1,000,000 \times 4\% = \$35,000$). Because the state General Fund receives Arizona individual income tax collections, General Fund revenues would decrease by \$(35,000).

HB 2183 requires ADE to administer the education savings trust program. The bill does not provide initial funding for this additional workload, but eventually would fund it through monies transferred into a new Statewide Educational Choice Administration Fund established by the bill. The fund would receive transfers from education savings trusts in the event that a trustee dies, ceases to be a resident of the state, or reaches 23 years of age.

Local Government Impact

The Urban Revenue Sharing formula distributes 15% of income taxes collected 2 years prior to incorporated cities and towns. HB 2183, therefore, could reduce these distributions by as much as \$(315,000) two years after interest earnings from education savings trusts is equivalent to interest earnings from Coverdell ESAs.

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